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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 284

LEON FALK, JR., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the Tax Court of the United States (R. 57-74) is reported in 15 T.C. 49. The opinion of the Court of Appeals (R. 76-83) is reported in 189 F. 2d 806.

JURISDICTION

The judgment of the Court of Appeals was entered on June 5, 1951. (R. 83.) The petition for a writ of certiorari was filed on August 28, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

1. Where, under the terms of a trust instrument, certain trust income is payable to such unnamed charities and in such amounts as the taxpayer shall direct, and any income not paid to such charities is payable each year to the taxpayer, is that part of the income actually paid to charities includible in taxpayer's gross income under Section 22(a) of the Internal Revenue Code?

2. Whether the provision of Section 23(o) of the Internal Revenue Code, limiting deductions for charitable gifts to fifteen per cent of a taxpayer's net income, is applicable to amounts actually paid to charities out of the trust income at the direction of the taxpayer.

STATUTES INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit,

or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(o) [As amended by Section 224 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Section 127 (c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Charitable and Other Contributions.*—In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

* * * * *

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States or of any State or Territory or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is

carrying on propaganda, or otherwise attempting, to influence legislation;

* * * * *

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection or of subsection (x). Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

STATEMENT

The facts as found by the Tax Court (R. 57-67) may be summarized as follows:

In 1927 the taxpayer's father created a trust, which became irrevocable in 1928 upon the death of the settlor, and which provided in Article Second for the distribution of income as follows (R. 42-43, 60-61):

Second. The Trustee shall pay over the dividends, interest and income from the trust estate, remaining after payment thereout of the expenses of maintenance, taxes or other proper disbursements, as follows:

1. To Marjorie Falk, the daughter of the Donor, there shall be paid annually in quarterly instalments, as near as may be, such portion of said income as the Donor in his life-

time and Leon Falk, Jr., the son of the Donor, after the death of the Donor, shall from time to time in writing direct; provided, however, that after the death of the Donor the amount so paid shall not be less than Five Thousand Dollars per year. The payments so to be made to said Marjorie Falk shall be made each year until the trust is terminated.

2. To such charities and benevolences, charitable, benevolent and educational institutions as the Donor in his lifetime, and as Leon Falk, Jr., after the death of the Donor shall, from time to time in writing, designate, there shall be paid such portion of said income as the Donor in his lifetime and Leon Falk, Jr., after the Donor's death shall direct, each year until the trust is terminated.

3. To Leon Falk, Jr., the son of the Donor, there shall be paid annually all of said income which shall not be paid to said Marjorie Falk and to Charitable, benevolent and educational purposes as aforesaid. The payments so to be made shall be made each year until the termination of the trust.

The trust was to terminate at the death of the taxpayer, Leon Falk, Jr., who had an unrestricted power of appointment over a substantial portion of the corpus. (R. 61.) From 1928 until 1946 the taxpayer directed payments to charitable, benevolent and educational institutions from the income of the trust estate, with the result that a total of about $504,000 was paid directly or indirectly from the net income of the trust during this period to

charitable and educational institutions. The net income of the trust for that period was $793,000. (R. 63.) During the year 1942 the trust estate paid almost $25,000 to charitable, benevolent and educational institutions (R. 63) and the balance of about $20,000 to the taxpayer (R. 64). During the year 1943 the trust estate paid about $51,000 to charitable, benevolent and educational institutions and the balance of about $1,200 to the taxpayer. (R. 64.)

The taxpayer's uncle, Maurice Falk, was trustee of the above-mentioned trust from 1928 until his death in 1946. (R. 60, 62, 66.) Prior to the death of Maurice Falk, the Commissioner had notified the taxpayer that he intended to include the income of the trust, in excess of $5,000 paid to the taxpayer's sister, in the taxpayer's income. (R. 67, 68.) Following the death of Maurice Falk, his executors filed in the Orphans' Court of Allegheny County, Pennsylvania, the first and final account of Maurice Falk as trustee under the deed of trust of 1927. The taxpayer was one of the executors of the estate of Maurice Falk. On September 18, 1946, there was filed in this proceeding by Eugene B. Strassburger, a co-executor with the taxpayer under the will of Maurice Falk, a petition for the appointment by the court of a trustee *ad litem* to represent "the interests of charitable, benevolent and educational institutions under section 2 of Article Second of the said deed of trust." On the

same day an order and decree was entered by the court, appointing one Arthur N. Scully as trustee *ad litem*. In that order and decree it was provided that the taxpayer here is "required to exercise a reasonable, fair and legal discretion in carrying out the provisions of the said Section 2 of Article Second of the said deed of trust and his exercise of such discretion is subject to supervision and review by this court." The order further adjudged that Maurice Falk as trustee "was required to exercise reasonable care to assure the proper performance by the said Leon Falk, Jr., of the latter's duties under the said Section 2 of Article Second of said deed of trust." There is no indication that a hearing or argument was held in this proceeding or that the taxpayer or any one else contested the petition. (R. 66.)

The Commissioner determined that the income of the trust, except $5,000 paid to the taxpayer's sister, should be included in the taxpayer's income for 1942 and 1943. (R. 68.) The taxpayer filed a petition in the Tax Court for review of the Commissioner's determination, which upheld the Commissioner's determination, except as to $4,000 additional income paid the taxpayer's sister in 1942. (R. 73-74.) The taxpayer appealed to the court below[1] (R. 2), which affirmed the decision of the Tax Court (R. 83).

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[1] The Commissioner did not appeal from that part of the Tax Court's decision which was adverse to him, relating to the $4,000 additional income paid to the taxpayer's sister in 1942.

ARGUMENT

1. The decision below is correct. It is not in conflict with any decision.

The trust instrument as applicable to the tax years involved provided that trust income (except the income paid to the taxpayer's sister, as to which there is no controversy) was payable to such charities and in such amounts as the taxpayer "shall direct", and that "all of said income which shall not be paid" to such charities was to be paid annually to the taxpayer. (R. 61.) Oral testimony was offered before the Tax Court in an attempt to show that taxpayer's father, the settlor, intended to impose upon the taxpayer a legal duty to cause distributions of net income to charitable and educational institutions, and that the performance of this duty was subject to review and enforcement by a court of equity. The Tax Court was unable to find from such testimony "a purpose to create a charitable fund which the petitioner was legally bound to distribute for charitable purposes." (R. 70.) With this finding the Court of Appeals agreed. Further, the Tax Court held, and the Court of Appeals agreed (R. 80):

> Neither the trust instrument nor any direction by the grantor has provided for the use of any specific amount of income for any particular charity or even for charity in general.

In short, under the terms of the trust instrument taxpayer had the power to retain all the trust

income for himself. Hence such income should be included in his gross income under Section 22(a) of the Internal Revenue Code, *supra,* even though he may in particular years have directed that all or a part of it be paid to charities. See *Jergens* v. *Commissioner,* 136 F. 2d 497 (C.A. 5th), certiorari denied, 320 U.S. 784; *Mallinckrodt* v. *Nunan,* 146 F. 2d 1 (C.A. 8th), certiorari denied, 324 U.S. 871; *Emery* v. *Commissioner,* 156 F. 2d 728 (C.A. 1st), certiorari denied, 329 U.S. 772; *Stix* v. *Commissioner,* 152 F. 2d 562 (C.A. 2d); *Bunting* v. *Commissioner,* 164 F. 2d 443 (C.A. 6th), certiorari denied, 333 U.S. 856.

Taxpayer further contends, and asserts as one of the reasons for granting the writ, that the uncontested decree of the state court is binding upon the federal courts. While we submit that such an uncontested decree is not binding upon the Government in tax matters, it seems clear that the decree here is of no aid to the taxpayer. The decree provided that the taxpayer was "required to exercise a reasonable, fair and legal discretion in carrying out the provisions of the said Section 2 of Article Second of the said deed of trust and his exercise of such discretion is subject to supervision and review by this court." (R. 66.) It is thus seen that the decree sets up no standard or legal yardstick to determine how much of the annual income of the trust must be devoted to charitable purposes. Hence, the taxpayer has failed to sustain his burden of showing the minimum

portion of the trust income which must be devoted to charities, and which was not within his absolute control. *Stix* v. *Commissioner, supra,* p. 563. Compare *Merchants Bank* v. *Commissioner,* 320 U.S. 256.

Nor is the construction placed upon the trust contrary to state law. Taxpayer argues (Pet. 13-19) that, in circumstances such as those which on his view of the evidence existed, the Pennsylvania courts will impose a constructive trust. It is, however, well settled in Pennsylvania that such a constructive trust will be imposed only on the basis of evidence which is direct, positive, express, unambiguous, and convincing. See *Brenneman Estate,* 360 Pa. 558, 563, 63 Atl. 2d 59; *Lalich* v. *Bankovsky,* 350 Pa. 441, 39 Atl. 2d 514. Here, as the courts below found, taxpayer's evidence failed to meet that standard. The taxpayer himself testified (R. 39) that his father never expressed to him a limitation as to the amount of the income from the trust which should go to charities. Taxpayer's unlimited control of the income is shown by the record. For example, he directed the payment of about $25,000 to charities in 1942, retaining for himself approximately $20,000 (R. 63-64), while in the year 1943 he directed the payment of $51,000 to charities and retained for himself $1,219.09 (R. 64).

2. Taxpayer further asserts as a reason for granting the writ, that even assuming that the

absence of a fiduciary duty gave him sufficient control over the income of the trust to render it his gross income within the meaning of Section 22(a), the amounts actually paid to charitable institutions are deductible without limitation, notwithstanding the provisions of Section 23(o) of the Internal Revenue Code, *supra,* which limit the deduction of an individual on account of charitable contributions to fifteen per cent of his net income. The Tax Court held that the amounts paid to charities constituted gifts to charity by the taxpayer. (R. 73). The Court of Appeals disposed of this contention of the taxpayer by stating that it was without merit and "need not be discussed." (R. 83.)

We believe the contention is clearly without merit. Section 162 of the Internal Revenue Code, cited by the taxpayer, deals with deductions allowable to trusts.[2] If, however, we are correct on the first point of this brief, it necessarily follows that the charitable gifts were made, not by a trust or out of trust income, but by taxpayer out of taxpayer's individual income. Taxpayer thus is seeking to apply to the individual, deductions allowed only to trusts. If his contention were to be up-

[2] Taxpayer's assertion that Section 4(a) of the Internal Revenue Code makes these provisions applicable to trust beneficiaries is beside the point. Section 4(a) provides that the General Provisions of Sections 11-64 are applicable "subject to the exceptions and additional provisions found in the Supplement". Since nothing in Section 162 relates to the treatment of charitable gifts made by the recipients of trust income, the General Provisions clearly apply.

held, the fifteen per cent limitation which Congress has placed upon charitable contributions made by individuals could be avoided by the simple expedient of executing a trust under which the individual may direct the payment of the income to charities or to himself as he may see fit. Clearly this is not the purpose of Section 162 of the Internal Revenue Code.

Old Colony Co. v. *Commissioner,* 301 U.S. 379, cited by the taxpayer, is not in point. There, there was no individual beneficiary upon whose sole discretion depended the question of whether income was to go to charity or to himself. The charitable contributions there involved were made by the trustee pursuant to the terms of the trust. Here, the charitable gifts were made by the individual out of income within his unfettered control.

CONCLUSION

The decision of the court below is correct and there is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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